Supreme Court of the United States

OCTOBER TERM, 1944.

No. ....

BUTLER DISMAN, PETITIONER,

VS.

SECURITIES AND EXCHANGE COMMISSION, RESPONDENT.

In the Matter of the Application of Securities and Exchange Commission to Enforce a Plan for Reorganization of the Southern Colorado Power Company; an Operating Public Utility Corporation.

BRIEF FOR PETITIONER IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A concise statement of the grounds on which the jurisdiction of this court is invoked is set forth in the foregoing petition, together with a Statement of Facts that are material to the consideration of the questions presented. These questions are restated herein as follows:

(1) Whether the Act authorizes the Commission to reorganize an operating public utility company that neither owns nor controls any other subsidiary utility company and by such process to compel preferred shareholders to relinquish their preference status, together with the other charter rights accorded to them, and to share with the common stockholders in a new issue of common stock; (2) Whether the plan approved by the Commission and the Court is necessary and appropriate to effectuate the provisions of the Act; (3) Whether the plan approved by the Commission and the Court is fair and equitable to the holders of the cumulative preferred stock; (4) Whether the Commission and the Court are acting within the intendment of the Act in directing an amendment of the charter of the Power Company without the consent or approval of the shareholders thereof, as required by the laws of the state of Colorado; (5) Whether, in the event, it is held that the enforcement of said plan is authorized by the Act, as so construed by this Court, said Act denies to the preferred shareholders equal protection of the laws, and deprives them of their property without due process of law, in violation of the provisions of Amendment V to the Constitution of the United States.

ARGUMENT.

This court in the case of *Otis & Company* v. *Securities and Exchange Commission,* 89 L. Ed. (Advance Opinions) 460, granted a Writ of Certiorari in order to determine certain fundamental principles involved in the interpretation of the Public Utility Holding Company Act of 1935, with particular reference to the distribution of assets owned and held by a holding company. The matter of the instant cause pertains to the application of the provisions of said Act to an operating electric utility company as distinguished from a holding company. The question was presented to the Circuit Court of Appeals for the Tenth Circuit, but no opinion was written by it for the decision of the case. The Court merely rendered a *per curiam* opinion, in which the order of the District Court of the United States for the District of Colorado, approving the proposed Plan of reorganization, was affirmed, on the authority of *Otis and Company* v. *Securities and Exchange Commission, supra.*

We submit that the instant case calls for a similar exercise of discretion by this Honorable Court for a review of the issues herein presented. This matter involves questions of great public importance by reason of the fact that many operating electric utility companies, that neither own nor control other subsidiary companies, have submitted, or are about to submit, plans under said Act, for reorganization and recapitalization. The basis on which the rights of the shareholders and other parties involved, depend, should be determined by this Honorable Court.

The action of the Commission and the judgment of the Court in approving the plan of reorganization is based

entirely upon an interpretation and application of the provisions of the said Act. A federal question, therefore, arises which demands determination. In *A. C. Frost & Co.* v. *Coeur D'Alene Mines Corp.*, 311 U. S. 624, 61 S. Ct. 9, 85 L. Ed. 386; 312 U. S. 38, 61 S. Ct. 414, 85 L. Ed. 500, a petition for certiorari was granted. This Court said:

> "This action was based wholly on interpretation and application of the Securities Act. Thus a federal question arose which demands determination."

In *Securities and Exchange Commission* v. *Chenery Corporation et al.*, 317 U. S. 609, 63 S. Ct. 52, 87 L. Ed. 494; 318 U. S. 80, 63 S. Ct. 454, 87 L. Ed. 626, this Court granted a writ of certiorari to review proceedings originating, as the instant one does, from an Order by the Commission approving a plan. This Court said:

> "Because the question presented looms large in the administration of the Act, we brought the case here."

The same reasoning applies with equal force to the situation presented in this petition.

I.

The Act Does Not Empower the Commission or the Court to Approve the Plan Submitted in This Case.

The Act, as its title indicates, was enacted for the purpose of eliminating a condition that had existed whereby so-called holding corporations were enabled, by means of ownership of small amounts of voting capital stock, to control divergent and widely scattered operating public utility corporations. This practice had grown to such proportions that Congress took note of it and by this law, provided that such holding corporations should regis-

ter with the Securities and Exchange Commission, which was authorized to administer said Act, and should within a given period of time simplify their corporate structures and divest themselves of such voting control over subsidiary companies. The purposes of the Act are clearly set forth in Section 79 (a) (1) thereof and include a manifest intention to terminate the sale and distribution of securities to the public that are based solely on the ownership of stock in subsidiary operating utility corporations and also to conclude the detrimental effects to the public generally as to the service and rates of subsidiary companies by reason of such foreign control. The corporations at which the law was directed were holding companies and not domestic utility operating organizations.

This purpose was succinctly stated in the Report of the Senate Committee on Interstate Commerce (Report No. 621, 74th Congress, 1st Session, Page 4) as follows:

> "Realistic 'Regulation' requires the readjustment of holding companies to a size and power, and to change relationship to their operating subsidiaries and the communities served thereby, which will give regulation a chance to be effective, and the so-called 'elimination' provisions of section 11 * * * are intended to create conditions under which effective regulation will be possible."

The Congressional reports and debates (H. Rep. No. 1318, 74th Congress, 1st Session, pp. 49-50; Cong. Rec. Vol. 79, pp. 8711-18) all show that in enacting Section 11 Congress intended merely to provide a method of limiting the size and extent of holding-company systems, of eliminating intermediate holding companies and of redistributing voting power among the holders of the securities of operating utility companies so as to decrease the extent of or to eliminate entirely control by holding com-

panies. Such reports and debates, and the act itself, further disclose, that Congress did not contemplate, under Section 11, interference with or reorganization of solvent operating utility companies unless the same should be necessary to correct inequalities of voting power among the security holders of the holding-company system.

It is our contention that there is absolutely nothing in the provisions of the Act that authorizes the Commission to revamp the fiscal and corporate structure of an operating public utility company and compel the stockholders thereof to relinquish, without their consent, rights vested in them and accept inferior securities. Section 11 (b) (1) does not so provide, and goes no further than to require the disposition by holding companies of stock interests that they are prohibited from retaining. While the steps to accomplish that purpose, so far as holding companies are concerned, may properly be within the scope of the Act, there is no authority expressed in this subsection, or in any other portion of the Act, that refers to the relative interests of security holders of a subsidiary utility operating company, or which requires them to surrender essential rights in order to purge the holding company. Therefore, while disposition by the Standard Gas and Electric Company of its voting control of the Power Company, in this instance, might properly have been within the purview of the Act, we respectfully submit there is nothing specified therein that empowered the Commission to impair the priority status of the security holders of the Power Company itself to secure that result.

Reorganizations affecting the rights of security holders are accomplished most commonly through the procedure of equity receiverships and the bankruptcy act. Under such proceedings and by the provisions of such act, reorganizations may not be affected unless the proposed plans have been accepted by a specified percentage

of security holders who have an interest in the assets of the corporation to be affected thereby. The difference in these requirements and those of Section 11 are so substantial as to indicate clearly that Congress did not intend, by this Act, to authorize such substantial changes of the rights of stockholders of an operating utility company as is proposed in the plan in question.

It is apparent that if Congress had intended to grant to the Commission the power to so materially modify the rights of security holders of such a company, without their approval or consent, there would have been a discussion of the reasons why the exercise of such power should not be circumscribed with the protection accorded to them under equity receiverships and the bankruptcy act. This merely emphasizes the conclusion that Congress did not have the intent, and certainly did not so state, that the Commission should have the right to reorganize an operating public utility company for the purpose of eliminating holding company control unless such a course should be necessary to effectuate the purposes at which the act was aimed. A further argument is herein submitted to show that such action in the instant case was not so necessary within the intendment of the Act.

II.

The Plan Is Neither Necessary nor Appropriate to Effectuate the Provisions of the Act.

In addition, to the contention that the Act is manifestly and exclusively directed to the elimination of control on the part of holding companies of subsidiary operating utility companies, it is our position further, that there is nothing in Section 11 (b) (2) of the Act that authorizes the Commission to require any change whatever in the corporate structure of such a company, except

for the definite purpose of fairly and equitably distributing voting power among the security holders of a holding-company system. In fact the section provides a specific exception to that effect.

> "Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company."

In this case, voting power could have been fairly and equitably distributed without depriving the preferred stockholders of their present rights, and the continuation of their preference status could not, under any hypothesis, provide a necessary provocation for action under this section. Voting power could have been fairly and equitably distributed by merely according to the common stockholders, for their present shares, as much or as little new common stock as the Commission might think they were entitled to have and by giving full voting rights to the preferred stock. It was not necessary for the Commission to go further in order to accomplish the desired result. The approved Plan, however, did go much further. It eliminated entirely all dividend arrearages to which such preferred stockholders were entitled and transferred them into common shareholders. In this respect, certainly it endeavored to change the corporate structure of an operating company for a purpose other than required. This, we submit, is in direct conflict with the above quoted section of the Act.

Even if the Commission had the power to approve such a plan, there is no basis for the finding by it that the plan was necessary to accomplish a redistribution of voting power. The Commission assigned no reason for so find-

ing, but merely made the following general statement for this jurisdictional purpose.

"Witnesses for Southern Colorado conceded that the present distribution of voting power among the security-holders of the company is repugnant to Section 11 (b) (2) and that a redistribution thereof is necessary. In view of the position of the Class B common stock with respect to assets and earnings (hereinafter discussed) and the fact that that stock has a majority of the voting power, these admissions are clearly correct, and we find that a redistribution of voting power is necessary to comply with Section 11 (b) (2). The plan is designed to effect such a redistribution.

"We have held, with judicial support, that inequitable distribution of voting power cannot be cured merely by transferring voting power to senior securities, leaving outstanding junior securities representing little or no interest in the enterprise; and in such cases we have concluded that the only adequate way to redistribute voting power is to confer it upon the holders of new securities in an enterprise recapitalized on a sound financial basis.

"The plan presented here was designed to achieve that purpose. With terms and conditions hereafter outlined with respect to debt retirements, we think that it will, in time, bring about a reasonably sound corporate structure. Thus we find that if the plan is fair and equitable, and if the conditions that we propose are met, the plan is necessary to effectuate the provisions of Section 11 (b)" (R. 20, 21).

This finding is a mere conclusion, and does not meet the requirements as announced by Mr. Justice Frankfurter in the case of *Securities and Exchange Commission* v. *Chenery Corporation, supra.*

"The Commission's action cannot be upheld merely because findings might have been made and considerations disclosed which would justify its order

as an appropriate safeguard for the interest protected by the Act. There must be a responsible finding."

We fail to see that there is any relationship between the mandatory requirements of Section 11 (b) (1), and the elimination of preference rights of the preferred shareholders. Furthermore, there are no conditions of Section 11 (b) (2) that require preferred shareholders to become common stockholders and the mere provision in the plan for such an exchange does not of itself establish that such action is "necessary" within the intendment of the Act especially when a far simpler method, without disturbance of established rights, is available.

In this connection, reference is also made to the statement in Respondent's brief before the Circuit Court of Appeals on Pages 38 and 39 thereof, as follows:

> "Upon the return of Southern Colorado to local control, as contemplated by the Act, its financial conditions should not be a hindrance to local interests. As the Commission has stated elsewhere, * * * it is not the purpose of Section 11 (e) or (11) (b) (2) any more than it is the purpose of the Bankruptcy Act to send forth cripples into the financial world."

This statement shows clearly that the Commission was looking more to a financial reorganization of the company than it was to a mere modification of voting rights. Attention is again directed to the Reports of the Committees of the Senate and House of Representatives on Interstate Commerce that were made to the Seventy-fourth Congress, 1st Session, at the time passage of the Act was under consideration, and with which were incorporated separate reports by Hon. Edward M. Eicher, then a member of the House of Representatives, and the National Power Policy Committee, together with the statement of the President of the United States. The Act was aimed

at the holding companies and the elimination on their part of voting control over operating companies. There was no suggestion that the Commission was to be empowered to work out a sound financial situation with reference to operating companies, even though perhaps such a result might be desirable.

Attention in this connection is further directed to the statement by Respondent in its brief before the Circuit Court of Appeals on Page 39:

> "The Commission has ordered Standard Gas to divest itself of the holdings of Southern Colorado securities, under Section 11 (b) (1). See *Standard Gas and Electric Co.*, 9 S. E. C. 862."

Under that factual situation, the voting control of the Power Company manifestly already had been terminated at the date of the hearing on the plan. The Standard Gas and Electric Company must either have sold its voting stock, distributed the same to its shareholders, or cancelled the same in its entirety. It is evident therefore, that the "necessity to effectuate the provisions of Subsection (b)" as set forth in Section (e) of the Public Utility Holding Company Act no longer exists and manifestly did not exist at the time these proceedings were initiated. The Commission was not proceeding with the plan in question to fairly and equitably distribute voting power, but rather for the clearly evident purpose of reorganizing the corporate structure of the Company. This the Commission is not authorized to do either under the provisions of the Act or the intendments thereof. It is moreover specifically prohibited from taking such action by the last paragraph of Section 11 (b) (2).

In accordance with the Plan approved by the Comission and the Court, all of the Class "B" common stock is to be eliminated as being entirely worthless and devoid

of consideration. This is the stock that holds the voting control of the Power Company. It is further clear, therefore, that if the sole purpose of the Commission was to "effectuate" the provisions of subsection "B" of the Act, and thereby to terminate the voting control by the Standard Gas and Electric Company the same was in fact accomplished by the provisions of the plan itself without further resort to elimination of the contractual rights of the preferred shareholders. It was not "necessary" to change the preferred shareholders into common stockholders in order to obviate the voting control of worthless stock that was, by such plan, to be delivered up for cancellation as null and void.

III.

The Plan Is Neither Fair Nor Equitable to the Holders of the Preferred Stock.

During the course of the last depression, Congress found it expedient to add Section 77B to the Bankruptcy Act in order, primarily, to permit financially embarrassed corporations, not individuals, who already had the benefits of Section 74, to treat with their secured creditors in such manner as to avoid the tremendous losses involved by foreclosure proceedings, and also to permit them to keep their property intact and their business in operation. Congress, however, was exceedingly careful and definite in its endeavor to avoid any possibility that the new enactment would deprive any person of his property without due process of law or that his interests would be discriminated against unfairly. The Statute therefore provided very clearly, that the same should be confirmed, only if the judge should be convinced that the same was fair and equitable and did not discriminate unfairly against any particular class of creditors or stockholders, even though proper consents were secured.

Congress very properly refused to sanction any provision that had for its purpose the taking from one and the giving to another without some compensating benefits. In other words that the property of one person should not be taken, either directly or indirectly, and given to others without adequate consideration. *Kansas City Terminal Railway Co.* v. *Central Union Trust Co. of New York*, 271 U. S. 445, 46 S. Ct. 549.

In the case of *Consolidated Rock Products Co.* v. *Du Bois*, 312 U. S. 510, pp. 527-528, 61 S. Ct. 675, this Court stated the rule as follows:

> "In the second place, and apart from the cancellation of interest, the plan does not satisfy the fixed principle of the Boyd case even on the assumption that the enterprise as a whole is solvent in the bankruptcy sense. The bondholders for the principal amount of their 6% bonds receive an equal face amount of new 5% income bonds and stock. True, the relative priorities are maintained. But the bondholders have not been made whole. They have received an inferior grade of securities, inferior in the sense that the interest rate has been reduced, a contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of preferred stock, and their former strategic position has been weakened. Those lost rights are of value. Full compensatory provision must be made for the entire bundle of rights which the creditors surrender."

The terms "fair and equitable" have now been accorded a recognized legal interpretation and the recent decision in the case of *Otis & Company* v. *Securities and Exchange Commission, supra,* has emphasized the same.

On an asset basis there is no question that the Common shareholders, both classes A and B, are without any rights whatever, to participation in this reorganization.

The majority of the Commission itself states that "there is no book equity for either the Class B or Class A stock" (R. 22). This situation is admitted by all and the figures taken from the *pro forma* balance sheet required of the Company by the Commission support the same.

The total over all capital valuations of the assets, as permitted by the Commission, after required necessary accounting adjustments, do not exceed $9,000,000 so that on this basis the assets are approximately $2,000,000 short of meeting the fixed debt liabilities of the Company and the par value of its preferred stock without the accruals thereon. No values therefore can possibly be found on these agreed facts to warrant any equity whatever for either the Class A or B common shares.

In view of this situation, the Commission has been forced to rely entirely on its own estimate of the future net earnings of the Company as a basis of awarding approximately 5% of the enterprise to the Class A shareholders. For this purpose, it simply decides that net earnings will sufficiently exceed $311,000 per year to justify this allocation to the valueless equity owners because only the annual sum of $297,612 is required to pay the preferred shareholders the yearly dividends to which they are now entitled without provision however for the unpaid or future arrearages. The Commission goes into great detail in attempting to justify this look into the future, because the past record of earnings does not support this conclusion in the slightest degree. For the past twelve years, earnings have not been sufficiently large to equal the required $7 per share on the preferred stock even without provision for adequate maintenance of the system. All agree that the generating equipment has not been maintained and that the same is "obsolescent, small and inefficient," and that after war-time demands

are met, the street railway system may become a liability instead of an asset.

The dissenting Commissioner computes that even on an established 6 1/2% capitalization of the gross revenues to be expected from the operations of the Company no value whatever can possibly be assigned to the common shareholders (R. 52, 53, 54).

In addition to the requirement under the plan that the preferred shareholders must permit the junior stockholders to share in 5% of the present net earnings of the system, they are also required to relinquish other valuable rights to which they are entitled and for which they paid valuable considerations, without any compensation whatsoever therefor. They are first directed to relinquish more than $1,300,000 in accrued and unpaid dividends. They are next ordered to surrender their preference status both as to assets and dividends and their rights to premium payments on redemption.

The elimination of $35 a share from the preferred shareholders is, of course, a substantial diminution of the same. This is done with a mere wave of the hand although the total represents a cash contribution of capital to the enterprise without which the common shares could have no possible value whatever.

The relinquishment of preferred status is a most serious deprivement of valuable rights. It is something to know that there is a first call on earnings and assets. This manifestly was the controlling principle that initially actuated the purchase of such shares and which the common stockholders acknowledged at the time they purchased their stock. Now, however, they are being required, without their consent, to share the future earnings of the Company with the junior shareholders, to stand on an equal basis with them and to accept for each share, having a par value of $100 and $35 accruals thereon, 10

shares of common stock having a stated value of only $4 to $5 a share. Such, we submit, cannot possibly be considered as "fair and equitable" to such security owners under any dictionary definition of those terms or under any other theory of jurisprudence or statutory construction.

The preferred stockholders have been receiving their dividends at least in part and have more definite prospects of receiving them in full in that status, than of receiving an equivalent as common shareholders. A preferred position with a fixed rate of return has been in the past and undoubtedly will in the future be more desirable to them than that of participants generally in the profits of the enterprise.

The Commission meets the elimination of preferred status with the statement that the preferred stock has a limited dividend rate, whereas, the common stock has a speculative expectation that earnings will accrue to it in the future, and, therefore, has some rights that must be respected. It dismisses lightly all contractual preferred provisions as constituting only a part of "a bundle of rights," and seeks to emphasize the right to participate generally in the net income which is to be evaluated by a forecast of the amounts thereof that are anticipated to be distributable. It refuses to give any recognition whatever to the amounts due for arrearages and concludes that "preferences are not permitted to operate so as to determine the allocations between the preferred and common stocks." It follows this with the asserted corollary that failure to compensate for dividends in arrears and other preference status rights in no way prejudices preferred stockholders.

We cannot agree with this method of reasoning. It is contrary to the facts. The preferred shareholders have definite contractual rights that are being cancelled and

for which they receive nothing except a right to participate in 94% of the net earnings 95 years in the future.

In a number of reorganization cases of utility holding companies, the Commission has awarded a participation to junior equity holders of a 5% interest in the enterprise. This apparently has been an arbitrary percentage, known as the 95-5 rule, and the same has in each instance been supported by the same reasoning as employed in the instant case, namely, that some recognition should be given to the junior holders whether they might legally be entitled to the same or not. This was the plan approved for the *United Light and Power Company* (Holding Company Act Release No. 4215, 7 S. E. C. 98), that was before this Court as *Otis and Company* v. *Securities and Exchange Commission, supra.*

The same situation existed with reference to the *Columbia Gas and Electric Corporation* (Holding Company Act Release No. 3885), *Puget Sound Power and Light Company* (Holding Company Act Release No. 4255), *Federal Water Service Corporation,* 8 S. E. C. Rep. 893, and *Community Power and Light Company,* 33 F. Supp. 901.

This Court, however, had no hesitation whatever in the cases of *Ecker* v. *Western Pacific Railroad Corporation,* 318 U. S. 448, 63 S. Ct. 692, and *Group of Institutional Investors* v. *Chicago, Milwaukee, St. Paul and Pacific Railroad Company,* 318 U. S. 523, 63 S. Ct. 727, in eliminating all participation in the reorganization, on the part of the common shareholders, when it was established that there was no reasonable equity in the enterprise to which they were entitled to share, under the established principles of law.

Attention is also directed to the very obvious fact that the District Court acted under a clear misapprehension of the equities of this situation. In the ruling of the Court

at the conclusion of the oral argument, the following statement was made to support the decision.

> "The relative rights and priorities of the old stockholders are maintained by the amount of the new stock that each share of the old gets. That is, in the distribution of the new securities, the relative rank of the contract rights and the rank of the old stockholders has been recognized. For instance, ten shares of new common stock is given for each share of the old 7% cumulative stock and all accumulated and unpaid dividends thereon. So old stockholders, owners of the 7% preferred, not only get ten shares of new common for each share of preferred they own, but stock for their past and accumulated unpaid dividends. The old Class A common stock gets one-fifth share of the new common stock for each share of the old Class A common stock" (R. 108, 109).

According to this reasoning, the Judge manifestly thought that he was conferring a favor on the preferred stockholders. In this he was clearly in error for the priorities of such shareholders are not being preserved. On the contrary, they are destroyed under the plan approved. He construed the Plan as giving to the senior shareholders something of value whereas in fact they are definitely being discriminated against in favor of the junior stockholders.

In the *Otis & Company case, supra*, the Company that was the subject of the controversy was a registered holding company and although the Commission found that it must be liquidated and dissolved, approved the proposed plan of reorganization that divided the assets of the Company in the ratio of 94.52% to the cumulative preferred shareholders and 5.48% to the common shareholders. It was agreed, by all parties in that case, that the

assets were insufficient, in amount, to equal the par value of the preferred stock and the accumulated dividends thereon, so the plan, as approved, was predicated solely and entirely on the assumption that, if the enterprise was to be allowed to continue, which it was not, the net income of the company, on a projected basis, would be sufficient to pay all arrearages on the preferred stock in approximately fifteen years, so that, at the end of that time, the common shareholders would be entitled to receive all of the net earnings of the Company, if any, over and above the amounts required for payment of current dividends on the preferred stock. This Court in its decision in that case states:

> "the Commission noted that if all the assumed earnings materialized and were applied to liquidating the preferred current deferred dividends, in approximately fifteen years, the arrearages would be paid and the common would be in a position to receive dividends."

The Court of Appeals in the same case says "the Commission has estimated that a fifteen year period will be required at best to reduce the arrearages of dividends to zero," and on the basis of this assumption, concluded:

> "If the plan be carried out, the preferred stockholders will give up about 5% of their exclusive claim to all of the income for a fifteen year period and 5% of their exclusive right to the first \$3,600,000 of income earned thereafter. In exchange, they receive a new right to 95% of the annual earnings in excess of \$3,600,000 which the Commission has estimated at \$2,585,000, to begin after the fifteen year period and to run as long as the system shall endure."

In general, therefore, it was held that the expectation of the common stockholders to share in the net income of the Company, in the future, was not so remote as to

exclude them from participation to some extent in the plan of reorganization.

In the case at bar, the Commission, after refusal to accept any earning estimates of the Company officials ("the testimony of witnesses for Southern Colorado, designed to show that on an earning basis there is an equity for the common stocks, has been of little aid to us") (R. 23) proceeded to draw its own conclusions which are restated as follows:

> "The estimated *pro forma* net income of the Company for the year 1942 after the adjustments previously discussed, is $312,000. The annual dividend required on the present preferred stock is $297,612. Thus it is estimated that after the re-financing preferred requirements will be somewhat more than covered. Even under this estimate, there is some surplus to apply on the accumulations" (R. 26 and 27).

The Commission reinforced this statement with the further conclusion which has been heretofore stated and is again set forth herein:

> "The circumstances mentioned above make it more likely in this case that the prospective income is an accurate approximation of the amounts available for dividend purposes. While the existence of accumulation of the preferred dividends of over a million three hundred thousand dollars would make it impossible for the Class 'A' stock to receive any dividends for a number of years, we think that there is sufficient possibility that the Class 'A' stock might *sometime* receive *some income* from the Company to warrant participation by the Class 'A' stock in the reorganization" (R. 28) (Italics ours).

These are substantially the net earnings relied on by the Commission for the computation of a five per cent allowance to the Class 'A' Stockholders and as Commissioner Healy states:

> "They simply decide that earnings of Southern Colorado will sufficiently exceed $311,000 per year, the pro forma average earnings for 1942-44, or $312,-000, pro forma earnings for 1942, to make the present Class 'A' worth 5% of the enterprise. This over-all judgment is made without further apparent attempt to show how or how much the earnings of the company will exceed $312,000" (R. 46).

Ninety-five per cent of the estimated net income of $312,000 is the equivalent of approximately $296,400, which is less than the amount required to pay the current dividend of seven per cent on the preferred stock. Five per cent of said estimated net income is approximately $15,600. On the theory, therefore, that the excess over the ninety-five per cent could be applied toward the liquidation of the arrearages on the preferred stock, on a continuing basis, it is manifest that a period in excess of ninety-five years would be required to make the preferred stockholders current with their dividend preference rights before the Class "A" stockholders could legally be permitted to participate therein. Commissioner Healy correctly analyzes this situation with the statement that has heretofore been set forth.

> "Thus even if all earnings could be paid out (an impracticable assumption), it would take ninety-five years to pay off the arrearages. * * * When common stock cannot be expected to participate for so many years, I do not believe it has a value" (R. 50).

In the *Otis and Company case, supra,* projection was made for a period of fifteen years. In this case projection must be made on a basis of ninety-five years at least. On the same line of reasoning, the Commission could, with equal logic, have concluded that "sometime" in the future there would be "some earnings" available for the Class "B" stock and thus have accorded the shareholders thereof some rights of participation.

Petitioner further urges in this connection that any estimate of earnings in the future must of necessity be a pure guess. Instead of earnings being of a net nature, they may in fact represent losses. The Commission is, therefore, in the anomalous position of now trying to do what the holding companies endeavored to do, namely, to look into the future in anticipation of net earnings on which to base the issuance of securities. The holding companies, with the aid of experienced business men, failed miserably in this crystal gazing and the Public Utility Holding Company Act was the result thereof. The Commission is now seeking to rely on the same nebulous theory of future forecasting.

The observation is also pertinent that if future earnings for the Class "A" stock can be ascertained with reasonable or approximate certainty, then the same should have a present value and it should not be necessary to reduce the stated values of the assets of the Company, as required by the Commission, to a figure that is less than the amount of the debt and the par value of the preferred stock.

Regardless of what guesses may be made as to future earnings, the facts are crystal clear that for the past twelve years, earnings of the company have not been sufficient in amount to pay the full preference requirements of the senior stock or even large enough, without such payments in full, to maintain the properties, because the Commission itself, has demanded that many millions of dollars be written off the asset column. Not only have actual earnings been less than the requirements, but there is a very likely possibility that they may be much lower in the future, because under the decreased asset valuations, the Public Service Commission of Colorado may insist on lower service rates.

Petitioner respectfully reiterates, therefore, that even on an earning basis, the plan in this instance cannot be supported as being fair and equitable to the preferred shareholders. If a reorganization is deemed necessary to eliminate the preferred stock, then all of the newly issued common stock should be given to shareholders thereof. If, however, as the Commission contends, the Class "A" stock does have a value, then the same should be given a junior position in any reclassification.

IV.

The Plan Is Not Feasible.

It has always been recognized that domestic corporations are subject to the laws of their domicile and are, except in certain instances, within the control of the regulatory bodies created by the states in which they are located. As above set forth, the Power Company is incorporated under the laws of the state of Colorado and is subject to the statutory enactments thereof. Section 52, Subdivision 3, of Chapter 41 of the Colorado Statutes, Annotated, specifically provides that if any proposed amendment to a certificate of incorporation should alter or change the preference given to any class of preferred stock, then the holders of such class to be so affected shall be entitled to vote, as a class, thereon, whether the terms of the certificate of incorporation provide such right or not, and that the affirmative vote of the holders of two-thirds of the amount of such preferred stock outstanding shall be necessary to the adoption of such an amendment, as well as the affirmative vote of the holders of two-thirds of all other classes of stock then outstanding.

This provision was in effect at the time the Power Company was incorporated, and the preferred sharehold-

ers purchased and acquired the shares of stock now held by them in full reliance on the observance of this enactment.

In order that the Plan in question can be made effective, it was necessary for the Commission and the Court to override and set aside this requirement of the State of Colorado under which the Power Company was authorized to conduct its business. It is our contention that the Plan is not feasible in its operation, if for the performance thereof it is necessary to violate a mandatory provision of the laws of the state which has sole jurisdiction and control over the proponent of the Plan.

The Bankruptcy Act specifically required that any proposed plan should not only be fair and equitable, but should also be feasible. The Act in question does not include a provision as to feasibility, but it is submitted that the well known implications of this latter term should, as a matter of course, be considered in connection with any plans required thereunder.

V.

If It Be Held That the Act Authorizes the Plan in Question Then Said Act Is Unconstitutional.

It is our contention in brief, that the elimination of the contractual rights of the preference stockholders, without their approval or consent, denies to them equal protection of the laws, and deprives them of their property rights without due process of law, in violation of the provision of Amendment V to the Constitution of the United States. We do not submit herein a comprehensive argument on this point, but do respectfully state, that if the Writ of Certiorari is granted, a detailed review will be presented to the effect that denial of the contractual rights of the preferred stockholders, as out-

lined in the plan involves an unconstitutional delegation by Congress of legislative power.

Wherefore it is respectfully submitted that this petition for a Writ of Certiorari to review the decision of the Circuit Court of Appeals for the Tenth Circuit should be granted.

Respectfully submitted,

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INDEX

CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 1181

BUTLER DISMAN, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The *per curiam* opinion of the circuit court of appeals (R. 125–126), affirming the order of the United States District Court for the District of Colorado which was entered upon application of the Securities and Exchange Commission, has not yet been officially reported. The oral opinion (R. 108) and the order of the district court (R. 109) are not reported. The findings and opinion of the Commission rendered August 23, 1943 (R. 6), and the Commission's order of November 24, 1943 (see R. 4, 110), approving Southern Colorado Power

Company's plan, as amended, for recapitalization of the Company, have not yet been officially reported but are set forth in the Commission's Holding Company Act Releases Nos. 4501 and 4704.

JURISDICTION

The judgment of the United States Circuit Court of Appeals for the Tenth Circuit was entered on February 21, 1945 (R. 126). The petition for a writ of certiorari was filed on April 19, 1945. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925, the provisions of which are made applicable by Section 25 of the Public Utility Holding Company Act of 1935 (the "Act"; 49 Stat. 803, 15 U. S. C. 79a *et seq.*).

STATUTE INVOLVED

The applicable provisions of the Act are set forth in the Appendix, *infra,* pp. 24–30). The substance of the relevant statutory provisions is as follows:

Under Section 11 (b) (2) of the Act, it is the duty of the Commission to require all registered holding companies and their subsidiaries to "take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security

holders, of such holding-company system." The requirement here involved is that calling for changes necessary to bring about equitable distribution of voting power in companies in holding-company systems.

To enable the Commission to *compel* compliance with its orders issued under Section 11 (b), the Commission is authorized by Section 11 (d) of the Act to resort to the district courts of the United States for enforcement thereof; and the courts are empowered, *inter alia,* to dispose of the corporate assets "in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing."

Of immediate application here is Section 11 (e), relating to *voluntary* compliance. Section 11 (e) permits a company subject to Section 11 (b) to "submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling" the company to comply with Section 11 (b). The Commission, after notice and opportunity for hearing, is authorized to consider whether the plan is "necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan," and, if the Commission so finds, to make an order approving the plan. Thereafter, the Commission is empowered, at the request of the company, to apply

to a district court "to enforce and carry out the terms and provisions of such plan." The court, after notice and opportunity for hearing, is authorized to "approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11" and is vested with jurisdiction to enforce the plan so approved.

QUESTIONS PRESENTED

1. Did the court below err in affirming, on the authority of this Court's decision in *Otis & Co.* v. *Securities and Exchange Commission,*[1] the conclusion of the Commission and the district court that the "fair and equitable" standard of Section 11 (e) as applied to the recapitalization of a solvent company permits an allocation of new securities, as between preferred and common stockholders, respectively, on a basis which reflects primarily their relative interests in future earnings under the existing structure, and does not treat the liquidation preference of the preferred stock as a matured claim?

2. Does Section 11 (e) as so construed and applied violate the Fifth Amendment of the Constitution?

3. Did the court below err in failing to find the plan "not feasible" because it did not contain a provision for a vote in conformity with the corporation laws of the state of incorporation?

4. Did the court below err in approving the

[1] No. 81, this Term, decided January 29, 1945.

plan in question in the face of objections, not raised by petitioner before the Commission or the district court, that (a) Section 11 (e) does not permit a plan for recapitalization of an operating company as a means of correcting inequitable distribution of voting power; and that (b) such a plan was inappropriate in this case because of the possibility that some other available remedy might have cured the inequitable distribution of voting power?

STATEMENT

The petitioner, an objecting preferred stockholder, seeks a review by this Court of the judgment of the United States Circuit Court of Appeals for the Tenth Circuit which affirmed an order of the United States District Court for the District of Colorado approving and enforcing a plan previously approved by the Securities and Exchange Commission under Section 11 (e) of the Public Utility Holding Company Act of 1935. The plan, proposed by Southern Colorado Power Company (hereinafter called "Southern Colorado"), provides in its amended form, as approved by the Commission, for the recapitalization of Southern Colorado in such manner that the present preferred, Class A and Class B stock of the company would be reclassified into shares of new common stock of which 95.1% would be distributed to the preferred and 4.9% to the Class A stockholders. The present Class B stock does not participate in the recapitalization.

Southern Colorado is a public utility subsidiary of Standard Gas and Electric Company (hereinafter called "Standard Gas"),[2] a holding company registered under the Act. Southern Colorado operates electric and transportation properties in and about the City of Pueblo, Colorado. As of October 31, 1942, Southern Colorado had outstanding the following securities (R. 9–10):

First Mortgage Gold Bonds 6% due July 1, 1947	$6,763,400.00
Other debt	$68,566.00
Total Long Term Debt	$6,831,966.00
7% Cumulative Preferred Stock par value $100 per share	42,516 shs.
Class A Common Stock par value $25 per share	110,000 shs.
Class B Common Stock without par value	75,000 shs.

The 7% Cumulative Preferred Stock (which will be referred to as the preferred stock) has a cumulative dividend preference of $7 per share per annum and a liquidation preference in the amount of $100 per share plus accrued unpaid dividends. As of August 31, 1942, the preferred stock was in arrears in the amount of $31.00 per share, aggregating $1,318,000 (R. 10). The aggregate liquidation preference as of that date was

[2] Standard Gas, a Delaware corporation, has its principal place of business in Illinois. It is in turn a subsidiary of Standard Power and Light Corporation, a Delaware corporation with its principal place of business in New Jersey.

Standard Gas is the holder of all the Class B common stock. It contended before the Commission and the district court that the Class B stock was entitled to participate, but it did not appeal from the district court's order sustaining the Commission's position that there was no equity for such stock.

thus $5,569,600. For the past ten years preferred dividend payments have not exceeded $4.25 per share in any year. Because of the dividend arrears each share of preferred stock, which is normally without voting rights, has one vote in the election of directors and on corporate matters generally, and the preferred stock now has an aggregate of 36% of the voting power of the company (R. 18).

The Class A stock is a junior preferred stock. It has a non-cumulative quarterly dividend preference of 75 cents per share before the Class B stock is entitled to any dividends, and it also has a liquidation preference of $27.50 per share before the Class B stock is entitled to participate. No dividends have been paid on the Class A stock since May, 1932. (R. 11.) The Class A stock has no voting rights under any circumstances. The Class B stock, all of which is owned by Standard Gas, enjoys exclusive voting rights except in the event of default on preferred dividends, and now has 64% of the voting power. (R. 18.)

The most conspicuous financial problem of Southern Colorado was that the company's property accounts contained inflationary items aggregating a net amount of more than $5,600,000 (R. 33–39, 50), whereas its earned surplus was less than $500,000 (R. 11). The necessity under the Act of having the company's books conform to reality thus gave rise to the possibility that

the company would have to charge the inflationary items to its earned surplus account, creating an enormous deficit in that account and preventing the payment of any dividends on the preferred stock for a great many years. The preferred stockholders, who had the largest stake among the stockholders of the company and were most keenly concerned over these conditions, were virtually disfranchised because of the almost two-thirds vote which Standard Gas could cast as owner of the worthless Class B stock. Other difficulties were presented by the large funded debt of the company due to mature in but a few years, and the high interest rate thereon, as well as the huge preferred arrears. Furthermore, because of its top-heavy corporate structure Southern Colorado was plainly in no position to raise any needed additional capital.

The plan in its final form as approved by the Commission and the district court provided as a first step for the refunding of Southern Colorado's outstanding first mortgage bonds. This first step has in fact been accomplished without objection and has resulted in interest savings in excess of $185,000 per annum before taxes. (R. 4.) The plan substitutes a single class of new common stock for the existing preferred, Class A and Class B common stock. By a determination which was disputed both before the Commission and the district court but which was not involved in the appeal to the circuit court of

appeals, the Class B stock held by Standard Gas received no participation. All of the new common stock was allocated among the existing preferred and Class A stockholders in the proportion of 95.1% to the preferred stockholders and 4.9% to the Class A stockholders.[3]

The Commission found this plan to be fair and equitable to the persons affected thereby and necessary to effectuate the provisions of Section 11(b). This conclusion rests on an appraisal of Southern Colorado's prospective earning power and a finding that absent reorganization to comply with Section 11 there was a reasonable possibility of paying off preferred dividend arrears and placing the Class A stock on a dividend paying basis. This possibility was considered sufficient to justify an approximate 5% allocation to the Class A stockholders for the surrender of their

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[3] These percentages result from an allocation of ten shares of new common to each share of preferred, and ⅕th share to each share of Class A stock.

The apparent discrepancy between these percentages and those mentioned by the petitioner (Pet. 7) is due to his failure to state that the 5,000 shares (1.11%) to be held temporarily in the company's treasury (for possible distribution to the Class B common stockholders) were to be cancelled without any change in the common capital stock account of the company in the event that Standard Gas, holder of the Class B stock, did not appeal from the Commission's order of approval or in the event that, on such appeal, the Commission's order was sustained insofar as it related to participation by the Class B stock (R. 65). The district court sustained the Commission and Standard Gas did not appeal further (R. 108–109; see note 2, *supra*).

existing rights. A contrary conclusion would have resulted from treating the charter liquidation preferences of the preferred stock, including accumulated arrears, as matured claims.

Upon the request of Southern Colorado the Commission applied to the United States District Court for the District of Colorado, pursuant to Sections 11 (e) and 18 (f) of the Act, to enforce and carry out the plan (R. 1). After hearing on notice to all stockholders[4] the district court approved the plan with appropriate findings by an order entered January 19, 1944. This order was affirmed by the court below upon the authority of the decision of this Court in *Otis & Co.* v. *Securities and Exchange Commission,* No. 81, this Term, decided January 29, 1945.

The circuit court of appeals had before it only issues of law since the record brought to it did not include the evidence before the Commission. Thus, there can be no factual issues before this Court. Assuming that the Commission was correct, in the context of the Holding Company Act,

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[4] The court ordered a public hearing on the Plan, and required publication of notice thereof in newspapers in Pueblo and Denver, Colorado, and Chicago, Illinois, as well as the mailing of notice to each stockholder at his last known address (R. 100–101).

Contrary to the implications in the petition (Pet. 7–8), there was ample notice to all stockholders of the hearings before the Commission and the district court. In fact, as a result of such notice petitioner appeared at such hearings, and was fully heard. All other stockholders had the same opportunity.

in evaluating the claims of the senior security holders as unmatured and therefore different from the claims which might be considered on similar securities in a bankruptcy reorganization, no question is raised or could be raised as to the correctness of the particular amount of such participation approved by the Commission. In regard to the fairness of the plan, the question is solely whether the common stockholders are entitled to *any* participation in the new securities.

The one argument in opposition to the plan which has been consistently pressed by petitioner before the Commission and in the courts below is based upon the views expressed by Commissioner Healy in a number of dissenting opinions, including that expressed in the instant case. We believe that that point has been disposed of by this Court's opinion in the *Otis* case and does not warrant further review. The other points were either not raised at all or were not extensively argued before the Commission and the district court, and are not dealt with by the opinion of the circuit court of appeals. While some of these questions may have been implicit in the statutory standards considered and applied by the Commission and the district court, they were not as fully dealt with as though they had been seriously contested. Although we believe it arguable that these questions may therefore not properly be subject to review upon writ of certiorari, we do not press this contention. We suggest, however, that the justifiable absence of

discussion in the opinion of the circuit court of appeals is relevant to the exercise of this Court's discretion as to whether or not to grant the writ.

ARGUMENT

1. The primary question presented by the petition is whether this case is governed by the decision of this Court in *Otis & Co.* v. *Securities and Exchange Commission,* No. 81, this Term, decided January 29, 1945. As this Court noted in the *Otis* case, the Commission recognizes and applies under Section 11 (e) the doctrine of full priority as applied to the preferential rights of preferred stock. The Commission has consistently construed the "fair and equitable" standard when applied to Section 11 (e) plans as not requiring it to measure the respective rights of junior and senior classes of stock exclusively in accordance with liquidation preferences. As in bankruptcy, the ultimate question is whether the new securities are the "equitable equivalent" of the rights surrendered, but since the liquidation preference is not treated as a matured claim no attempt is made to determine the present value of the assets. Thus the ultimate question decided by the Commission in this case was whether the relative participations accorded to the preferred and common stocks were commensurate with their relative expectations of participation in future earnings under the existing capitalization of Southern Colorado. On that precise issue, as it arose in the *Otis* case, this Court

held that the Commission had "applied the correct rule of law as to the rights of the stockholders inter sese." Slip-sheet opinion, p. 7.

In the *Otis* case a further question was presented as to whether the Commission had properly applied this standard in a case where the plan took the form of a liquidation within the letter of the charter liquidation preference. This Court construed the charter liquidation preference as inapplicable to a liquidation required by the statute. This problem is not present in the instant case, for what is here involved is in form, as well as in substance, a reorganization in which the same corporation continues the same business under an altered capital structure. To treat the presently unmatured liquidation preference of the preferred stockholders as matured by this recapitalization would be to go beyond the letter of the charter provisions as well as to violate the substantive equities recognized in the *Otis* case.

Petitioner has attempted to distinguish the *Otis* case on the assumption that the earnings prospects of the Class A stock of Southern Colorado under the existing structure are less promising than the prospects of the common stock of United Light & Power Company involved in the *Otis* case. A major difficulty with this ground for seeking review is that neither in the *Otis* case nor in this case was the evidence upon which the Commission and the district court upheld the plans in question made part of the record on appeal. Furthermore,

insofar as petitioner bases this attack upon the findings of the Commission, we believe that he has presented an inadequate analysis of those findings.

Although neither the Commission nor the dissenting Commissioner attempted a precise estimate of future earnings, both opinions reviewed in considerable detail the evidence of earning power in the record. Among the data considered was the fact that the earnings from electric utility operations alone for the year 1942, and also the average for the years 1942 to 1944, amounted to approximately $312,000 after adjustments to reflect the estimated savings from the refunding of Southern Colorado's debt and to reflect certain revisions in accounting practice contemplated by the plan.[5] While this is only slightly in excess of the $297,612 annual dividend requirement on the preferred stock, and thus gives rise to the 95-year pay-off possibility emphasized by petitioner (Pet. 36–37), neither the Commission nor the dissenting Commissoner[6] regarded these figures as approaching the upward range of possible earn-

[5] The Commission in its opinion estimated net earnings (adjusted) for 1942 at $312,000, and the average for the years 1942–1944 at $311,000 (R. 26–29).

[6] Commissioner Healy stated that he considered $735,000 per annum as "a fair maximum estimate of gross income for the company" (R. 51). Income deductions on the basis of new debt are $245,000 (R. 89), so that this estimate results in a maximum net income of $490,000, which is to be compared with current preferred dividend requirements of $297,612. It should be added that if the majority of the Commission had thought this forecast sound (and Commissioner Healy apparently did not, for he characterized it as "maximum"

ing power. In fact they are substantially less than earnings for the most recently available period [7] and did not take into account any earnings from Southern Colorado's street railway properties which, although currently substantial under wartime conditions, were regarded by the Commission as ephemeral. Nor did they take into account large but nonrecurring tax savings by reason of the deductions allowed for premiums paid on the refunding of the bonds, nor any increase in future income which might flow from the use of the company's excess cash estimated at $457,000 (R. 50, 27). The Commission properly gave weight to the speculative but none the less substantial prospects for future income in excess of $312,000 per annum in determining whether it could properly find that the Class A stock had any value under the existing structure (R. 27–28). Among the uncertainties considered were post-war rates of taxation. For the five-year period prior to 1942 (that is, prior to the wartime increase both in operating revenues and in taxation) net

and "quite optimistic" (R. 54)), a participation greater than 5% for the Class A stock might have been warranted. For on this basis, the preferred would be giving up the right to 4.9% of $490,000, or $24,000 a year, for 8 years, and would receive in exchange 95.1% of $190,000, or $181,000 a year, in perpetuity beginning in 8 years.

[7] For the most recently available period, namely 12 months ending August 31, 1943, the net income was at the rate of $387,000 (adjusting retroactively for the refunding of the bonds and including the street railway earnings) (R. 89).

income averaged $444,500 after adjustment to reflect interest savings resulting from the refunding of the bonds. Whatever range of possible dispute might be suggested by these earnings figures if the question of the precise allocation of the new common stock were to be examined *de novo,* no such issue can now be raised. Since the circuit court of appeals did not have before it the evidence which was before the Commission and the district court, it was not called upon to, and did not, review upon factual grounds the finding that the plan is fair and equitable.[8]

Since the only question of interpretation is one which was answered by this Court in the *Otis* case and which as presented here is shorn of some of

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[8] Petitioner's effort to distinguish the *Otis* case also involves an over-simplification of the findings of the Commission which were before this Court in that case. Petitioner gives the impression that the Commission made a definitive finding in the *Otis* case that all arrears would be paid off in 15 years. On the contrary, the Commission, after stating that this would result if consolidated earnings equaled the figures assumed by the Commission and if all consolidated earnings were available for distribution by the top holding company, expressly referred to the optimistic nature of these assumptions, stating: "Under the assumptions we have stated, it is recognized that at best the interest of the common stock in earnings is remote" (Holding Company Act Release No. 4215, p. 19).

As was pointed out in the Government's brief in the *Otis* case (p. 16), the Commission's conclusion that approximately 95% of Railways' common stock should go to the preferred stockholders involved the implicit application of a discount rate of approximately 15% to the earnings estimates used by the Commission.

the difficulties which divided the Court in that case, and since there is no basis for making factual distinctions between the two cases, we submit that petitioner's contentions regarding the application of the "fair and equitable" standard present no question warranting review by this Court.

2. Petitioner asserts, without briefing the point (Pet. 40), that if Section 11 (e) authorizes the plan in question it is unconstitutional, emphasizing primarily the Fifth Amendment to the Constitution but also adverting to alleged unconstitutional delegation of legislative power. While petitioner made some general constitutional references in his objections to the plan filed in the district court and in his notice of appeal (R. 102, 107–108, 120), the point was not briefed in either of the courts below.

As we understand the present contention, it amounts to nothing more than an emphatic statement of his argument that the plan is inequitable—so inequitable as to violate constitutional rights. Petitioner apparently would not urge such constitutional arguments in opposition to a "fair and equitable" plan. *Continental Ill. N. B. & T. Co.* v. *C. R. I. & P. Ry. Co.*, 294 U. S. 648. Thus, no real constitutional issue can be presented. If the plan is unfair it fails for contravention of the statutory standard; if fair, the alleged constitutional difficulty disappears.

3. Petitioner, without questioning the general validity of Section 11 (b) or Section 11 (e),

argues that the present plan is not feasible because it does not provide for such vote as, apart from the provisions of Section 11 (e), would be necessary to effectuate a charter amendment under the Colorado incorporation statutes. If any substantial difficulty were presented by this contention, we would, of course, concede its importance in the administration of Section 11, as well as in the field of bankruptcy reorganization. We believe that the simple answer to the question is that the stockholders' voting rights under state law are superseded by paramount federal law. See *Continental Insurance Co.* v. *United States, Reading Co., et al.,* 259 U. S. 156. We are aware of no cases which point to the constitutional necessity of a vote where a reorganization is necessary to comply with the policy of a federal statute except as that statute itself may contain provisions for a vote.[9] Since the question is not

[9] Section 11 (e) followed the analogy of the equity precedents under the antitrust laws instead of borrowing the express voting requirements from the bankruptcy reorganization statutes. This is for the obvious reason that Congress did not wish to give any class of security holders the power to veto compliance with Section 11. Moreover, the voting requirements of Chapter X and Section 77 are based upon pertinent federal policy and make no effort to conform to requirements of state incorporation laws. Thus, no vote is required for a class of security holders found to have no equity, and even where a class does have an equity, the percentage of votes specified is unrelated to requirements of state law, and a vote may even be dispensed with entirely under certain circumstances. See Chapter X, §§ 179 and 216 (7) and (8), and Section 77 (e), second and third paragraphs.

one which appears to have given any difficulty to the lower courts, it does not appear that review by this Court is necessary.

4. Although petitioner did not, either before the Commission or the district court, question the propriety of substituting a single class of common stock for the existing preferred, Class A, and Class B stocks, he argued for the first time to the circuit court of appeals and now to this Court that, regardless of the allocation, no such plan should have been approved. Petitioner's argument rests in part upon what we believe to be a misreading of the provisions of Section 11 (b) (2), on the basis of which he urges that the Commission would lack power in any case to require recapitalization of an operating company, and in part upon his disagreement with the views of the Commission and the district court as to the necessity and appropriateness of requiring a recapitalization in this case. Neither contention warrants the issuance of a writ of certiorari.

Petitioner apparently would have the Commission resolve the inequitable distribution of voting power in Southern Colorado's security structure merely by shifting dominant voting rights to its preferred stockholders. The effect of such a step would be to leave the Class A and Class B common stocks outstanding without any other change in the capital structure, which now includes huge

preferred arrears, a Class A stock which is in effect a junior non-cumulative preferred which must wait a long time for any return and even then would receive but a portion of its dividend preference, and a common stock with no perceptible expectation of ever receiving any return. As the Commission has stated elsewhere,[10] "* * * it is not the purpose of Section 11 (e) or 11 (b) (2) any more than it is the purpose of the Bankruptcy Act, to send forth cripples into the financial world." Continuation of the existing capital structure would be a hindrance to the raising of new equity capital, to the detriment of both investors and consumers. Moreover, since the required revisions in Southern Colorado's accounts will leave it with an initial deficit in its earned surplus account in excess of $5,000,000 (R. 11, 33–39, 40), petitioner's construction would have a most unfortunate effect on his own position as a preferred stockholder, since it would prevent the Commission from requiring even such changes in corporate structure as are necessary to absorb this deficit and put the company in a position to pay dividends out of current earnings.

But petitioner makes the further argument that the statute compels such an impracticable solution of Southern Colorado's problems.

This argument is based chiefly on the third

[10] *North Shore Gas Company*, 10 S. E. C. 504, 521 (Holding Company Act Rel. No. 3131, p. 17), citing *Price* v. *Spokane Silver & Lead Co.*, 97 F. 2d 237, 247 (C. C. A. 8), certiorari denied, 305 U. S. 626.

sentence of Section 11 (b) (2), which reads as follows:

> Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission and such courts as have considered the problem have uniformly construed this language as permitting any "change in the corporate structure or existence of" an operating company found necessary "for the purpose of fairly and equitably distributing voting power." [11] This construction has been adopted by district courts in Florida, Massachusetts, Missouri, and Delaware,[12] and by the Ciruit Court of Appeals for the Second Circuit, which is the only circuit court of appeals other than the court below which has had the problem before it. In *Okin* v. *Securi-*

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[11] The Commission's reasons for this construction were fully articulated in *Jacksonville Gas Co.*, Holding Company Act Rel. No. 3570, cited and relied upon by the Commission in this case (R. 20, 21).

[12] *In re Jacksonville Gas Co.*, 46 F. Supp. 852 (D. Fla.); *In re Puget Sound Power & Light Co.* (E. D. Mass., unreported); *In re The Laclede Gas Light Co.*, 57 F. Supp. 997 (E. D. Mo.); *In re United Gas Corp.*, 58 F. Supp. 501 (D. Del.). The Commission's opinions in these cases are in Holding Company Act Rels. Nos. 3570, 4255, 5062, and 5271, respectively.

ties and Exchange Commission, 145 F. 2d 913 (C. C. A. 2), the court affirmed an order of the Commission which authorized a holding company subject to a dissolution order to increase its investment in preferred stock of an operating subsidiary with a view to converting that preferred stock into common stock and helping to correct inequitable distribution of voting power in that subsidiary. The court stated, *inter alia* (at p. 914):

> The condition which the Commission has attached to its order here under review is based upon § 11 (b) (2) of the Act * * * which, while denying power to the Commission to change the corporate structure of a public utility company not a holding company, makes exception where necessary to avoid undue or unnecessary complication of the structure, or unfair or inequitable distribution of voting power among security holders, of the holding-company system.

Although the Commission did point out that petitioner's argument in the court below was in the nature of an afterthought not raised either before the district court or before the Commission, the question was fully briefed on both sides. In these circumstances we believe that the absence of any discussion of the point in the opinion of the circuit court of appeals reflects concurrence by that court in our view that petitioner's argument is unsubstantial.

A construction in accordance with petitioner's

view would undoubtedly be a matter of substantial public importance. However, we believe that the decision of the court below was clearly correct; and since no conflict of authorities is presented or suggested we submit that there is no occasion for review by this Court.

CONCLUSION

Since there is no conflict in the authorities on any of the points involved, and since on the only question which was adequately presented by petitioner before the Commission and the courts below the case is squarely within the decision of this Court in *Otis & Co.* v. *Securities and Exchange Commission*, No. 81, this Term, we respectfully submit that the petition for certiorari should be denied.

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May 1945.

APPENDIX

The pertinent provisions of the Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803 (15 U. S. C. 79 *et seq.*), are as follows:

> SECTION 1. (a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce; (4) their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.
>
> (b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572

(Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present prob-

lems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated become persistent and widespread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of

such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

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SECTION 11 (a). It shall be the duty of the Commission to examine the corporate structure of every registered holding company and subsidiary company thereof, the relationships among the companies in the holding-company system of every such company and the character of the interests thereof and the properties owned or controlled thereby to determine the extent to which the corporate structure of such holding-company system and the companies therein may be simplified, unnecessary complexities therein eliminated, voting power fairly and equitably distributed among the holders of securities thereof, and the properties and business thereof confined to those necessary or appropriate to the operations of an integrated public-utility system.

SECTION 11 (b) (2). (b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

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(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system. In carrying out the provisions of this paragraph the Commis-

sion shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

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SECTION 11 (d). The Commission may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce compliance with any order issued under subsection (b). In any such proceeding, the court as a court of equity may, to such extent as it deems necessary for purposes of enforcement of such order, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction, in any such proceeding, to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer under the direction of the court the assets so possessed. In any proceeding for the enforcement of an order of the Commission issued under subsection (b), the trustee with the approval of the court shall have power to dispose of any or all of such assets and,

subject to such terms and conditions as the court may prescribe, may make such disposition in accordance with a fair and equitable reorganization plan which shall have been approved by the Commission after opportunity for hearing. Such reorganization plan may be proposed in the first instance by the Commission, or, subject to such rules and regulations as the Commission may deem necessary or appropriate in the public interest or for the protection of investors, by any person having a bona fide interest (as defined by the rules and regulations of the Commission) in the reorganization.

SECTION 11 (e). In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any subsidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18,

to enforce and carry out the terms and provisions of such plan. If upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable, and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

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